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Presentation of

United Grain Growers Limited

to the

Royal Commission

on

Co-operatives

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INTRODUCTION

United Grain Growers Limited is a co-operative. It is farmer-owned and controlled with a membership of approximately 35,000 prairie farmers. Originally incorporated in 1906 as The Grain Growers' Grain Company Limited, it now has a record of almost forty years of successful operation. It is, in fact, one of the oldest co-operatives in Canada. It is also one of the largest. Information as to the activities of the Company as a co-operative is available in the Annual Report on Co-operatives published by the Department of Agriculture.

The Company is a direct outgrowth of the farmers' movement in the early years of this century. It represents the first effort of that movement to improve the position of the western farmer under the difficult and trying conditions of pioneer life on the prairies by directly entering the commercial field of marketing and handling grain. The accepted authorities on co-operative development in Canada have made extensive references to it and to the services it rendered to western farmers in improving conditions affecting the marketing of grain. It pioneered the field of co-operative handling and marketing of livestock. It differs from the majority of co-operative enterprises in Canada in that it is engaged both in marketing its members' products and in the distribution of such necessary farm supplies as coal, flour, feed, binder twine, salt, wire and other like commodities. In that field it was also the pioneer. Its constitution and form of organization conform as closely to the Rochdale plan as that of any other large co-operative and certainly represents the adaptation of that plan to conditions prevailing on the prairies in the first twenty years of this century.

The Company is unique in that it is the only co-operative producers' organization incorporated by special Act of the Parliament of Canada. Having regard to the fact that Parliament passed that Act, and particularly to certain provisions inserted therein by Parliament as late as 1941, it may be assumed that the Act fairly represents Parliament's conception of co-operative organization.

The Company is also unique in the length of time and extent to which, as a co-operative, it has paid Income Tax. Its action in this respect and its attempts to secure equality of tax treatment with competing co-operatives will be referred to later.

THE COMPANY'S BUSINESS

The Company owns and operates 529 country elevators, mainly in the Provinces of Manitoba, Saskatchewan and Alberta, with three in British Columbia. It owns and operates a terminal elevator at Port Arthur with a capacity of 5,500,000 bushels, with temporary annexes adjacent thereto with a capacity of 4,000,000 bushels. It also operates under lease a terminal at Vancouver, with a capacity of 2,600,000 bushels, and another at Victoria, B.C., with a capacity of 1,000,000 bushels. For the establishment and conduct of such an extensive elevator system, large sums of money are required. The balance sheet of the Company shows that at the end of the last fiscal year it had invested \$11,847,441.00 in capital facilities. That amount does not include \$1,125,000.00 spent since 1941 on temporary storage annexes adjacent to country and terminal elevators. Funds for the creation of these capital assets, beyond the amounts contributed by members, were not obtained by deductions from the proceeds of the sale of members' grain nor by holding back cash represented by deferred payment certificates, but by building up reserves and using the same to extend services to farmers throughout the West.

The Company has borrowed extensively. Outstanding bonds now total only \$2,600,000.00, but the Company's bonded and mortgage debt has, in the past, stood as high as \$5,000,000.00. Due to a good credit standing, the Company has issued bonds at rates comparing favourably with those prevailing for other industrial bonds. The last financial statement shows bank borrowings of over \$10,500,000.00. These have sometimes been over \$20,000,000.00.

The Company's activities may be described under four headings: its grain business, its farm supplies business, its educational and cultural work and its incidental business.

GRAIN BUSINESS:

During its first six years the business of the Company was largely confined to selling on commission grain consigned to it by members and patrons. Occasionally it bought grain in carload lots for subsequent resale. Some business is still done on the commission basis.

In 1912 the Company entered the elevator business. A complete elevator system receives grain in wagon and truck loads at country elevators and discharges most of it from terminals in cargo lots into the holds of lake vessels or ocean-going ships. The entry of the

Company into that business meant handling and storing grain at tariff rates. In addition the Company has operated as agent for the sale of grain, and as principal in buying and selling grain on the open market. It has also acted on behalf of The Canadian Wheat Board in receiving, handling and storing grain, and in making initial payments therefor. Until that Board was established in 1935, the Company operated in the open market. At first farmers valued highly the right to have their grain handled and sold as special binned, te., with its identity preserved in special bins in country elevators, so that it could be graded in carload lots by Government inspectors. Gradually, with improvements in elevator service, including both grading at country points and prices offered there, farmers came to prefer to dispose of their grain on a cash basis at country points. With respect to such grain, this Company has been accustomed to join with other elevator companies in a daily broadcast of prices offered, for the information both of the general public and of elevator agents. The usual practice has been to make contracts for forward sale to avoid risk of changes in price levels. Such forward contracts have in the past been largely made through the Winnipeg Futures Market. With respect to grain not acquired on a cash basis, which is handled or stored in elevators, tariffs are set annually by the Board of Grain Commissioners. Any Company may operate on lower tariffs by filing same with the Board. Each Company knows the tariffs under which its competitors are operating.

From the inception of The Canadian Wheat Board in 1935 until September 27th, 1943, with the exception of a two year interval, farmers had a choice between delivering their wheat to the Board and selling on the open market. As a rule they chose the latter method during such times as open market prices were higher than the initial payment offered by the Board. On September 27th, 1943, open market trading in wheat was suspended by the Government and thereafter all western wheat went to the Board. The elevator company receives, pays for and handles all wheat as agent for the Board under an agreement, the terms of which are usually settled annually in conferences between the Board and the various companies. We have always been assured that these are uniform in terms.

Since March, 1942, all flax deliveries at country elevators have been purchased by the Company for account of the Canadian Wheat Board. Oats, barley and rye are still bought and sold under open market conditions.

Meeting one or more competing companies at the majority of points at which it has elevators, the Company is aware of the business methods of its competitors and can therefore say that except for that period from 1923 to 1930 when the Wheat Pools operated on a

contract pool basis, the methods of operation of all companies, including the Pool Elevator Companies, have been alike. The grain business is one of the most competitive in Canada. It is also one of the most closely regulated. The effect of competition, of The Canada Grain Act and of Board regulation is that business methods of elevator companies whether co-operatives or not must be much the same.

This Company, through its association with the Canadian Council of Agriculture, as well as by independent action through The Grain Growers' Guide, played a considerable part in shaping and securing amendments from time to time of The Canada Grain Act. It has claimed and it has been accorded credit for much of the improvement in the grain and elevator business which has undoubtedly taken place over the years. That improvement has taken place is evidenced by the fact that in contrast to the experience of previous commissions, practically no complaints as to country elevator service were received by the Royal Grain Inquiry Commission of 1936-37.

FARM SUPPLIES BUSINESS:

The Company was the first co-operative to undertake in a large way the distribution of commodities such as binder twine, coal, flour, feeds, salt, oils and greases and other supplies required on the farms. It distributes annually, for example, from nine to twelve million pounds of binder twine, depending on crop conditions. It owns and operates a plant in the City of Edmonton for the manufacture of a complete line of livestock feeds, most of which is sold and distributed through its country elevators.

EDUCATIONAL AND CULTURAL:

Through a wholly owned subsidiary the Company publishes The Country Guide, a monthly farm magazine, with a circulation of 185,000. The publication was originally established in 1908 as a weekly paper under the name of The Grain Growers' Guide. It is well and favourably known for its educational and cultural work, as well as for its advocacy of policies to promote the welfare of western farmers.

The Company has contributed largely to the support of educational and social work among farm people of the prairies. It has made annual grants to such organizations as The Manitoba Federation of Agriculture, The United Farmers of Alberta, The Canadian Council and later The Canadian Federation, of Agriculture, The Canadian Council for Adult Education, Community Life Schools, conducted under University direction in Alberta and Manitoba, and Rural

Extension and Research work through the Universities. Grants of this kind over the years now total over \$400,000.00. The Company's record in this respect compares favourably with that of any other co-operative.

INCIDENTAL BUSINESS:

The wholly owned subsidiary, The Public Press Limited, was incorporated to print and publish The Grain Growers' Guide. It also does all of the Company's printing and in connection with this it does a certain amount of general printing.

United Grain Growers Securities Company Limited was incorporated in 1918 mainly for the purpose of acting as agent in placing and taking care of insurance on the various plants of the Company and its subsidiaries, and on grain handled by the Company. Hail, fire, automobile and accident insurance is written for farmers and to some extent for the general public.

Service to farmers has been the guide to the extension of the Company's business. Sales of binder twine relate to the harvesting of the crop; other supplies enter into the farmers' cost of production. The insurance business gives service to farmers and at the same time represents a reduction in costs to the Company in handling grain. In England and elsewhere the conduct of educational work is regarded as an essential function of co-operatives and The Country Guide is cultural and educational in its objectives.

The accounts of the Company are presented annually in consolidated form. Coffice of the consolidated Balance Sheets and Profit and Loss Statements for the past five years are filed herewith.

THE COMPANY'S ORGANIZATION

We have referred to the Company as the pioneer co-operative of Western Canada. This Company and other co-operatives in the West did not begin as part of a deliberately planned co-operative movement. They sprang rather from what has been described as the farmers' movement, and along with certain non-commercial farm organizations, were founded to solve in a practical manner the specific problems presented at different times to western farmers.

The early years of the present century were years of great expansion on the prairies, due primarily to the unprecedented rate at which land settlement was carried on under the Dominion free homestead policy. While railroad extension followed settlement westward, and roads were hastily constructed, still communication facilities were not good and the comparative isolation of farming communities encouraged the formation of local farm associations and facilitated the development of central farm organizations. As farm economy was largely based on grain production it was only natural that grain handling and problems of marketing should be the main concern of those organizations.

Grievances of farmers at that time arose out of pioneer conditions as settlement and grain production expanded more rapidly than the ability of railways to give satisfactory service. They arose partly from the slow growth of effective competition in grain buying and handling in the country. Elevators were needed at country points and although the railways at first provided terminal elevators they did not desire to provide country elevators. To encourage elevator building they gave a monopoly of grain handling at country points to established elevators, and refused, except in special cases, to allow farmers at such points the privilege of loading their own cars. (See Patton—"Grain Growers Co-operation in Western Canada," p. 14.) That situation inevitably led to abuses and resentment. In addition, trouble arose from lack of satisfactory provision either for regulating the grain trade or for grain grading.

Three different courses were followed in an endeavor to secure improvement, namely:

- (1) Parliamentary agitation which began in 1898 and led to the passing of the first Manitoba Grain Act.
- (2) The formation of the Territorial Grain Growers' Association in 1901, the Manitoba Grain Growers' Association in

1903 and, subsequently, similar organizations in Saskatchewan and Alberta.

(3) The organization of The Grain Growers' Grain Company in 1906 due to the development in the membership of the said organizations of the opinion that it was necessary for a farmer-controlled company to engage in the grain business. Not until some years later was the operation of elevators considered, as at that time farmers favored Government operation thereof.

As there then existed no adequate legislation to provide for the incorporation of a co-operative, the Company was incorporated under the Manitoba Companies' Act. From the beginning it advertised its intention to pay patronage dividends, but was forced to abandon that intention for reasons which will be referred to later. It did, however, obtain from the Manitoba Legislature (Manitoba Statutes—1909, C. 89) special legislation to provide for two other co-operative features, namely: a limit of four to the number of shares which could be held by any one person and equal voting rights for all members, regardless of the number of shares held.

In 1911, the Company applied for and obtained a special Act of Parliament (C. 80, 1911) incorporating the Grain Growers' Grain Company Limited. The Act provided for:

- (1) Authorized capital; \$2,000,000.00, divided into shares of \$25.00 par value. (S. 4.)
- (2) Only farmers or the owners and lessees of farm lands and the wives of such persons to hold shares. (S. 6.)
- (3) No person to hold over 40 shares. (S. 5.)
- (4) One man, one vote. (S. 8.)
- (5) Authority to distribute patronage dividends, but to share-holders only, after payment of a dividend on capital stock at a rate of at least eight per cent, and after setting aside such reserves as deemed necessary by Board of Directors. (S. 17.)

The payment of patronage dividends in this first Dominion. Act was restricted to shareholders, notwithstanding the application of the Company to be empowered to pay such dividends to both shareholders and patrons.

In 1915 the Company obtained an amending Act (Statutes of Canada—1915, C. 73), giving it the right to pay patronage dividends to both shareholders and patrons, leaving to the discretion of the Directors the rate of dividend payable on share capital (S. 6). That rate was later established at five per cent.

In 1911 the Saskatchewan Legislature, following the report of a Royal Commission, passed an Act (Statutes of Saskatchewan, 1910-11, C 39) incorporating the Saskatchewan Co-operative Elevator Company Limited, a farmer-controlled company, empowered to acquire and operate elevators. The Government loaned 85 per cent of the cost repayable over a long term of years. The power to pay patronage dividends, to both shareholders and customers, after payment of dividends on capital stock, was included. This Company and the Saskatchewan Co-operative Elevator Company were for years members, and the principal supporters, of the Canadian Council of Agriculture.

The Manitoba Government brought to an end a brief and unsuccessful period of Government ownership and operation of country elevators by leasing in 1912 and subsequently selling its line to the Company.

In Alberta in 1913, the Alberta Farmers' Co-operative Elevator Company Limited was incorporated. (1913, 1st Sess. C. 13.) The Alberta Government assisted in the acquisition of elevators in the same way as did the Saskatchewan Government.

The Acts incorporating these three companies followed almost exactly the same basic form of organization, viz.: share capital with a limitation of share holdings, the principle of "one man, one vote," and the power in the Directors to refuse their consent to the transfer of shares. They differed only in detail, such as the par value of shares and the rate of dividends to be paid on share capital before payment of patronage dividends.

It was during this same period that the Prairie Provincial Governments first passed legislation to provide for the incorporation of co-operatives. Each provincial Act provided for the share capital form of organization, and still in Alberta consumers' co-operatives can only be incorporated on that basis with a statutory priority for payment of dividends on share capital before payment of patronage dividends.

It is clear, therefore, that co-operation in Western Canada was founded on Rochdale principles with the share capital form of organization, including the payment of interest on share capital, a fact which, perhaps, was not sufficiently considered in drafting Section 4 (p) of the Income War Tax Act.



In 1916 the Grain Growers' Grain Company and the Alberta Farmers' Co-operative Elevator Company agreed to amalgamate. To carry the amalgamation into effect amendments to the Charter of the former Company were obtained (Statutes of Canada, 1917, C. 79) which provided for:

- (a) Change of name from Grain Growers' Grain' Company Limited to United Grain Growers Limited. (S. 1.)
- (b) Increase in capital from two to five million dollars. (S. 3.)
- (c) The grouping of members into territorial units called locals, the election by such locals of delegates to attend general meetings of the Company and the right of each of such delegates to one vote at a general meeting. (S. 6.)

Since 1917 the shareholders of the Company have been divided into locals, each of which elects a delegate to attend and vote at general meetings. Only delegates can vote at such meetings. To insure representation, the Company pays the expense of delegates. At present there are 281 locals and 267 delegates attended the last annual meeting in November, 1944. The Board of Directors numbers 12. At each annual meeting four Directors are elected for a three-year term.

In 1923 the Alberta Wheat Pool was formed and in the following year the Saskatchewan and Manitoba Wheat Pools. In these organizations, membership and the rights and obligations of members were largely fixed by contract, under which the Corporation acted as Factor and Agent for marketing the produce of members and was bound to account to them according to the terms of the contract. In each case the contract further provided that the Pool could obtain capital funds by deductions from the sale price of the produce for elevator and commercial reserves. (See Patton—"Grain Growers' Co-operation in Western Canada," p. 244 et seq., and for the form of contract, p. 429.)

In the following years a number of co-operatives were organized on similar lines, notably for the marketing of livestock and dairy products. At first each was organized on the basis of a marketing contract generally similar in terms to that used by the Wheat Pools, but adapted to the commodity handled.

To facilitate the development of co-operatives seeking incorporation along such lines, legislation was enacted in each of the three Prairie Provinces. The Alberta Act (1924, C. 5) may be cited as an example. It provides:

- 1. That Associations may be organized upon either capital stock or membership basis.
- 2. That if upon a membership basis then the Memorandum of Association must state whether the interest of each member is to be the same as that of every other member, and if the interest of each member is not the same as that of other members then the Memorandum of Association must set out the way in which such interest is to be determined.

The Manitoba Act (C. 36, R.S.M. 1940, S. 126) differs from the Alberta Act in that it declares that if the Association is organized upon a membership basis the interest of each member must be the same as that of every other member.

From evidence already submitted to your Commission you will be aware that a number of co-operatives have been organized under these Provincial Acts which have the following characteristics:

- 1. A small initial membership fee only.
- 2. Interest of members in assets on an equal or some other defined basis.
- 3. Capital provided in either of two ways:
 - (a) Loan capital basis—with or without interest, or
 - (b) By issuing deferred patronage dividend certificates, in lieu of cash on the revolving fund principle with or without interest.

Evidence has been submitted to your Commission to show that while a few producers' co-operatives still retain the contract form of organization others have abandoned it and in such cases membership is now based on a small membership fee. A number of these have adopted the revolving fund method of providing capital, sometimes without payment of interest.

Following the abandonment of the contractual basis of grain deliveries in 1930, the three Pools adopted different forms of reorganization. In the case of one of these organizations, the Alberta Wheat Pool, its Act of Incorporation as amended from time to time, still provides:

1. That membership is primarily based upon contributions to reserves.

2. That the interest of the members in assets of the Pool shall be in proportion to their contributions thereto.

The Act makes no provision for payment of interest on reserves and there is no statutory direction with respect to distribution of surplus.

In actual practice, the three Pools after 1930 ceased to pay interest on the very substantial amounts of capital contributed by their members. That fact has a very important bearing on the application of the Income Tax Act to the Pool Elevator Companies and to this Company, while the wide acceptance of the revolving fund method of providing capital without interest makes the problem more general in nature.

A close comparison of the membership plan of organization with the share capital plan prevailing prior to 1920, and still widely prevailing, shows that the essential difference lies in:

- 1. The qualification of a member, which in some cases depends upon a very small or a nominal fee, instead of upon some contribution to the resources of the organization.
- 2. The method of providing capital. The need for capital is small in the case of some organizations, but the co-operative elevator companies have all required it in large amounts, and to a total of well over thirty million dollars.

Whatever the method of qualifying members, and whatever the method of obtaining capital, this Company submits that such differences as exist do not warrant different treatment of different co-operatives for Income Tax purposes.

With the advent of the world depression in 1929 the Company was confronted with inter-related problems, which increased in importance year by year. In view of the very low prices prevailing for all farm products in the early thirties, farmers could not be persuaded to pay more than a nominal amount for membership privileges in any organization. At the same time, after the Company had been in operation for a quarter of a century or more, it was inevitable that to an increasing extent, year by year, many of the original members would die or retire from business. This Company, like all co-operatives, aims to identify as closely as possible its customers and its members. Under these existing conditions, the task of maintaining in the hands of farmers the shares of deceased or retiring members presented difficulties. That problem, and the need for some

change in the Company's Charter to meet it, was recognized and discussed by the delegates in annual meeting as early as 1938.

In the result the Company obtained from Parliament amendments to its Charter (Statutes of Canada—1940-41, C. 40) by which existing shares of \$25.00 par value could be and subsequently by By-law were divided into two classes, viz.: Class "A" shares of par value \$20.00 and Class "B" shares of par value \$5.00. These classes were by the By-law respectively made subject to the following limitations and privileges:

CLASS "A" SHARES-PAR VALUE \$20.00:

- (a) Non-voting.
- (b) Redeemable by purchase, or by call in whole or in part at \$24.00 per share.
- (c) Limitation of holding 250 shares.
- (d) Annual dividend not exceeding 5% in any year when earnings permit before payment of patronage or other dividend.

CLASS "B" SHARES—PAR VALUE \$5.00:

- (a) Voting privileges to holders of this class only.
 - (b) Ownership limited to farmers and the lessees or owners of farm land.
 - (c) Ownership, limited to 25 shares.
 - (d) One man, one vote.
 - (e) Right to participate in patronage dividends.
 - (f) The right of the Company to repurchase and resell these shares, but it may not at any one time hold more than 10% of the total number outstanding. (1940-1941, C. 40, Sec. 7(4).)

The right to repurchase the Class "B" voting shares, regarded by the Company as important for identifying its customer and its member bodies, and in preserving its co-operative status, was not obtained without difficulty. Hansard records that while the Bill was in Committee of the House, the Leader of the Opposition stated that the right was a most unusual one, but that after hearing the explanation of the Company's solicitor as to the necessity for same, he would not object to the provision. As the Company maintains a price of \$5.00 on these shares, members wishing to withdraw this part of their capital have been able to do so.

As shown by Appendix "A" hereto, it is well recognized that a co-operative organized on a share capital basis may have shares of different kinds.

It is an indication of the extent to which Parliament still protects the rights of shareholders that this amending Bill only passed the Senate when the Company accepted an amendment that no other dividends could be paid until the Company had first paid to the extent earned the stipulated rate on the Class "A" shares. (1940-41-C. 40, Sec. 2.)

Finally, it should be noted that throughout the discussion during the two annual meetings of 1939 and 1940 it was made clear that the Company proposed to resume payment of patronage dividends, authority for which had already been given the Directors by By-law.

THE COMPANY AS A CO-OPERATIVE

In order to present clearly the Company's position as a co-operative in relation to the Income War Tax Act, it is necessary to appraise its position in relation to other co-operatives, which in Canada have taken many forms. There is no set pattern and there is probably no definition that all would accept. Two tests might be applied:

- (a) Does its form of organization conform to those plans which are generally accepted as co-operative?
- (b) Has it been accepted as a co-operative by those authorities who are recognized as qualified to judge?

As to (a) it has been shown that in organization and structure the Company conforms substantially to the principles of the Rochdale plan which was the foundation upon which the co-operative movement was built. Certainly it is an adaptation of that plan to conditions in Western Canada in the first twenty years of this century as evidenced by Dominion and Provincial legislation passed during that time. Apart from the method of providing capital it is not fundamentally different from those conceptions of co-operative organization which have prevailed in Western Canada since 1923.

In this connection we refer you to certain definitions and descriptions of co-operatives within which this Company's organization squarely comes:

The official definition of a co-operative as used by the Dominion Government in "Farmers' Co-operative Business Organizations," 1938-39 (p. 2), and elsewhere in annual reports on co-operative organizations published by the Department of Agriculture:

"For the purpose of this record a farmers' co-operative business association is defined as a business organization owned or controlled by the farmer patrons, i.e., farmers who use its services, and operated in their interest."

From "Co-operation, Its Problems and Possibilities," by A. Honora Enfield, Secretary International Co-operative Women's Guild, published by the Workers' Educational Association:

"In all these different forms of societies in which the co-operative principle has taken shape—Producers', Consumers', Credit and Agricultural—there is something in common. All

are governed by the members themselves on the democratic principle of one man, one vote, regardless of the number of shares held. In all, the capital necessary for the enterprise is hired at a fixed rate of interest which is regarded as part of the running costs, and capital has no share of the profit or surplus as it is now more usually called." (pp. 12 and 13.)

From Co-operation, General Survey, by Elsie Gluck in Encyclopaedia of the Social Sciences, Vol. 4, p. 360:

"In the minds of the leaders of most of these movements there was no necessary conflict between the various forms of co-operatives. So far as the internal organization of the associations themselves was concerned, the term co-operative had some basis in common practises: voting was on the principle of individual membership rather than of stock held; membership was open; dividends on capital were fixed or limited; occasionally share holdings were limited; provisions were made for the return of surplus to the members on the basis of patronage, a fraction of this surplus being retained usually in a common fund for the furtherance of the ends of the co-operative organization."

- As to (b) the Company fortunately has been the subject of numerous examinations by competent observers, and their testimony is available in authoritative works.
- Dr. C. R. Fay, formerly a fellow of Christ's College, Cambridge, and later Professor of Economic History at the University of Toronto, in his book, "Co-operation at Home and Abroad" (1925) under the heading, "The Prairie Provinces," dealing in particular with Manitoba and Alberta, devotes six pages to the story of this Company. The passage is quoted in Appendix "B."
- Dr. H. S. Patton published in 1928 "Grain Growers' Co-operation in Western Canada." A very large part of this book is taken up with the history and experience of this Company, along with that of the Saskatchewan Co-operative Elevator Company Limited. The position of the Company as a co-operative is fully recognized.
- In 1932 Dr. D. A. MacGibbon, a member of the Board of Grain Commissioners for Canada, published "The Canadian Grain Trade." He devotes several pages, commencing at p. 48, to the early history of this Company and clearly recognizes its co-operative status.

In 1924 Dr. W. A. Mackintosh published his "Agricultural Co-operation in Western Canada." On p. 103 he quotes with approval from Powell's "Fundamental Principles of Co-operation in Agriculture," the following definition of an Agricultural Co-operative:

"It is an association of farmers who unite in an effort to handle their common interest through an agency which is controlled by them on the principles of an Industrial Democracy, and exclusively for their benefit."

Dr. Mackintosh then goes on to say:

"Assuming the truth of the above comprehensive definition, it may be fairly argued that the farmers' grain companies of Western Canada, although they exhibit many variations from normal types, are truly co-operative. It is just to say that the object of creation and operation has not been the making of profits for individuals. Insofar as the object has been profits, it has been profits for expansion and organization rather than for individual appropriation. The limitation of the amount of holdings to twenty shares in the case of the Saskatchewan company and one hundred shares in the case of United Grain Growers; the replacement of proxy voting by the Annual Meeting of elected delegates and the rule of 'one man, one vote' are all substantial safeguards against the danger of the companies falling under the control of non-producers or of a few producers with profits as their aim. The limitation on the amount of investment and of the dividend paid makes of less importance the rate of the dividend on stock."

Reference is also made to a study published in American Cooperation, 1927, Vol. 1, p. 26, by Chris. L. Christensen, Chief of the Co-operative Marketing Division of the Bureau of Agricultural Economics, Department of Agriculture, at Washington. He makes an extensive survey of the Company and favorably compares it with co-operative grain companies in the United States.

Other works, the authors of which treat the Company as a co-operative, are:

"History of Farmers' Movements in Canada," by Louis Aubrey Wood, pp. 311-314.

"Principles and Practices of Co-operative Marketing," by A. G. Mears and Matthew O. Tobriner at pp. 439 to 440.

"Co-operation, Its Problems and Possibilities," by Honora Enfield (Secretary of The International Co-operative Women's Guild), p. 62.

THE COMPANY AND PATRONAGE DIVIDENDS

Patronage dividends have an important relation to co-operative tax problems and for that reason some account of the Company's experience in this respect is necessary. In the early years of its history it did not pay patronage dividends. As a young Company seeking to develop and expand an enterprise which would be an efficient instrument in improving grain marketing conditions, it found itself confronted with many problems of an accounting and financial nature which, having regard to its main objective, caused its members and its directors to regard the payment of such dividends as of secondary importance, although at no time did the Company abandon its determination to exercise its rights in this respect when conditions warranted such action.

In examining the general literature on the subject of co-operation, you will perhaps have noted the great emphasis laid upon patronage dividends in connection with consumers' co-operation and the very limited reference to such dividends in the treatment of agricultural co-operation. For example, the book on "Agricultural Co-operation," by H. W. Wolff, formerly president of the International Co-operative Alliance, mentions the word "dividend" only once, when on p. 17 the author refers to "dividend hunger" as the bane of certain co-operatives in Great Britain. He stresses instead the improvement in marketing conditions and in agriculture itself as the objects of the movement.

Insistence on the right to pay such dividends led to the first crisis in the history of the Company—its expulsion from trading privileges on the Winnipeg Grain and Produce Exchange shortly after it commenced business in 1906, the story of which has been told by a number of writers. (See Mackintosh, p. 22—Patton, p. 50.) That event was a serious blow to the Company, which, at that time, was operating entirely as a Commission Agency. The Government of Manitoba intervened in the dispute and as there appeared to be some doubt of the Company's right to pay the dividends under its Manitoba Charter, and as it was not strong financially, it agreed to forego its plans in this respect for a time.

Both before and after the right in question was obtained from Parliament, the interests of the Company's members seemed to be much better served by other application of surplus revenues than their allocation to patronage dividends, since by 1912 the Company was committed to the policy of acquiring and operating country elevators. To operate such a line a strong financial position was essential.

One of the first steps taken by the Company after the amalgamation of 1917 was to send a delegation to the United States to study Agricultural Co-operatives there and to report upon the results of their experience with respect to patronage dividends. The delegation consisted of Mr. H. W. Wood, President of the United Farmers of Alberta: Mr. Peter Wright, a member of the Board of Directors of the Manitoba Grain Growers' Association and Mr. C. Rice-Jones, Vice-President of the Company. The delegation found that dangers, difficulties and dissatisfaction had arisen from the payment of patronage dividends by grain co-operatives there. It found everywhere an appreciation of the development in Western Canada and a feeling that it was much sounder than that in the United States. It also found that the payment of patronage dividends in the United States had a tendency to encourage locally owned elevators to buy on a very wide margin. The delegation recommended that the Company should continue to work toward the payment of such dividends, but should take the greatest care in working out a plan of operation.

Dr. Mackintosh, in his book at p. 90 et seq, examines the Company's record, refers to the difficulty of arriving at a satisfactory basis for the distribution of patronage dividends in view of the way in which grain was handled through country elevators at that time and approves of the decision of the Company to extend its services and to decrease margins, rather than to pay such dividends. He sums up his endorsement of the Company's policy in this respect by saying at p. 98:

"To be effective and to survive, rather than to be unspotted but impotent in the pure orthodoxy of the Co-operative gospel, would seem to have been the aim of the grain companies."

Again, on p. 148, he says:

"By thrusting forward through co-operation his business organization to the central market, the farmer is enabled to organize his productive enterprise according to market results which he is in a position to distinguish and interpret. The immediate cause of co-operative enterprise may be and usually is abuse of power by selling or purchasing firms, but the results go far beyond the mere regulation of a trade, important as that is, and the benefits are not to be judged merely on the basis of quantitative efficiency, of getting the largest turnover with the

smallest cost, but upon the effect of co-operation in relating the producer to his market."

Dr. Patton at p. 194 endorses the Company's position in those years in the following words:

"The rebate to patrons of earnings in excess of a fixed maximum return on share capital was realized to be incompatible with the financing of additional facilities and extended services through the reinvestment of earnings. Minute individual patronage disbursements—even if a satisfactory method of distribution could be worked out—were felt to be of less advantage to\grain growers as a whole than the enlargement of the resources and serviceableness of the farmer's companies."

By 1924 it was possible to envisage payment of patronage dividends on grain purchased by the Company on delivery at country elevators, and a resolution authorizing that procedure was passed. Commencing in August, 1925, and continuing for four years the Company issued dividend certificates on the purchase of such grain. Those issued for the crop years, 1925-26, 1926-27 and 1927-28 were later redeemed at the rate of one cent per bushel. Those issued during the crop year, 1928-29 were not redeemed because of the disturbed conditions of the grain market in the fall of 1929. With the beginning of the crop year, 1929-30, the Company faced ten years of world depression, and it requires only a glance at the table presented on p. 24 hereof to show how impossible it would have been for the Company to pay patronage dividends during that period. In four of the years the Company operated at a loss, and in three did not make any payment of dividend on share capital. It was not until the fiscal year 1940-41 that patronage dividends again seemed practicable. For that year \$200,000.00 was appropriated and paid out at the rate of one-half cent per bushel on all grain handled by the Company. In the following years, as shown by the table, it appropriated a total of \$2,000,000.00 to patronage dividends, giving rise to a tax problem which is discussed later.

THE COMPANY IN RELATION TO INCOME TAX

This Company has paid Income Tax since the inception of the Income War Tax Act, and has paid in all a much larger sum than any other co-operative. When the Income War Tax Act was passed, in 1917, the Company, as one of the large farmer-controlled cooperatives doing business at that time, did not seek exemption nor make any effort to escape liability. The reason for this is not difficult to understand. It was a member of the Canadian Council of Agriculture, which prior to the enactment of the Income War Tax Act, was one of the first advocates of both personal and corporation Income Tax. (See the Farmers' Platform of 1916, quoted by Hopkins Moorhouse, "Deep Furrows," p. 298.) Any other attitude taken by the Company would have been inconsistent with its position as a member of the Council and with the support given to the Farmers' Platform by the Company's publication. Moreover, the rate of Income Tax was not high at that time and the amount of the tax was not a matter of concern.

The Income War Tax Act was amended in 1930 by the insertion of Section 4 (p). The Company took no part in seeking that amendment. It is significant that it was passed at a time when the contract pool plan was at its peak in Canada. The collapse in grain prices which led to the discontinuance of that plan by the Wheat Pools had only just begun. Moreover, a reading of the amendment and the fact that the section seems obviously to have been taken from a similar section in the Internal Revenue Code of the United States (See Hulbert—"Legal Phases of Co-operative Associations," p. 250), would seem to indicate that it was designed particularly to meet that form of co-operative which was obligated by contract to distribute its surplus earnings among its members. In any event, the Company assumed when the Act was amended by the insertion of Section 4 (p) that it was not qualified to seek exemption thereunder.

For a few years after the amendment, Income Taxation continued to be a matter of comparatively small importance to the Company. With the fall in prices commencing in the autumn of 1929 and continuing for some years thereafter, and with increasing areas in Western Canada afflicted with drought, actual survival was to be a problem for many organizations. The increasing rates of taxation from 1935 onward, presented however, a problem of increasing gravity, especially as other co-operatives in the grain trade, meeting this Company at many points, appeared to enjoy tax exemption and at least one had started to pay patronage dividends.

The table on the following page sets out the extent to which the Company has been and may be affected by the Income War Tax Act and the Excess Profits Tax Act from the fiscal year ending July 31st, 1929, to that ending July 31st, 1944. With respect to the last five years the taxes are estimated only, as assessments have not been completed. The table commences with the year 1929 as that was the first fiscal year in which the accounts of the Company were presented in a consolidated form.

TABLE

UNITED GRAIN GROWERS LIMITED AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF TAXABLE INCOME AND TAXES AS PAID AND ESTIMATED

Years 1929 to 1944, Inclusive.

Financial Year Ended July 31	Bushels Received at Country Elevators (in Thousands)	Net Taxable Income (1)	Dominion Income and Excess Profits Taxes Paid and Accrued (2)	Patronage of Dividends Charged as Expense in Arriving at Net Taxable Income (3)	Dominion Income and Excess Profits Taxes Payable if Patronage Dividends Disallowed as Expense (4)
1929	36,952	8 494,281	\$ 59,382	8 ,	\$ 39,382
1930	17,891	(617,946)		· ·/	
1981	29,095	225,159	25,842	· · · · · · · · · · · ·	25,842
1932	28,739	248,513	38,549		33,549
1933	33,516	(31,145)	•		
1934	22,519	226,312	33,946		33,946
1935	92, 901	187,080	31,857		31,857
1936	19,664	-8,993	488		. 488
,1937	17,706	(544,359)			
1938	19,719	(398,959)	2,175 ·		2,175
1939	30,480	24,311	¹ 4,862		4,862
1940	37,081	627,354	183,579		1 8 3,579
1941	41,058	489,057	185,026	200,000	288,774 .
1942	25,579	346,779	145,644	375,000	319,677
1943	39,975	464,635	195,146	400,000	494,961
1944	48,673	503,610	211,516	1;225,000	1,177,416
•			\$1,003,012 ⁽⁵⁾	• ,	\$2,636,508

 In 1930 no depreciation on Country Elevators and Terminals was provided as appropriations in this respect for previous years had been made in excess of requirements.

In 1937 and 1938 no depreciation was provided on such buildings, but Net Taxable Income has been adjusted by one half normal depreciation, in accordance with current Income Tax regulations.

- 2. Taxes for 1940, 1941, 1942, 1943 and 1944 are estimated. Assessments for these years have not yet been made by the Income Tax Department.
- 3. Amount of Patronage Dividend shown for 1941 was paid.
 Amounts for 1942, 1943 and 1944 are held in Reserve, as the result of uncertainty of tax liability thereon, to be referred to later.
- 4. After deducting refundable portion of the Excess Profits Tax for 1942, 1948 and 1944.
- 5. Had it been possible to charge cash dividends paid to shareholders as a deductible expense for tax purposes, it is calculated that Income and Excess Profits Taxes as paid or estimated would be reduced by \$456,000.00 for the period of 16 years.

The table shows very clearly the fluctuating nature of the income of companies engaged in the operation of country and terminal elevators and how seriously changing conditions may affect operating results in any year. There are few more hazardous or uncertain businesses. Operating results from year to year depend directly—upon weather and crop conditions, not only in Canada, but in other wheat-producing countries of the world. Again the variable nature of crop conditions intensifies the competitive nature of the business. Under conditions which have prevailed during the past five years, the elevator capacity of Western Canada has been strained to the utmost, and, in fact, many temporary annexes have been built. Previously, however, when crops were light, as they were during a series of years from 1930 on, it appeared that the elevator capacity in Western Canada was altogether excessive and extreme competition resulted among operating companies.

The table indicates the position of the Company under the Excess Profits Tax Act. The standard years of 1936, 1937, 1938 and 1939 were years of low earnings and an application was, therefore, made to the Board of Referees for the determination of standard profits. Evidence submitted before the Board showed that during the period from the fiscal year ending 31st July, 1929, to that ending 31st July, 1939, the earnings of the Company after payment of Income Tax, averaged slightly less than two per cent per year on the capital employed. During that ten-year period the statement shows heavy losses in 1930, 1937 and 1938, and only very low earnings in other years. Ordinarily, it would have been expected that those losses would have been recouped in the years following 1939. The table makes it clear, however, that with the high rates of taxation now prevailing under the Income War Tax Act and the Excess Profits Tax Act, the Company, after paying taxes and the moderate rate of five per cent on its share capital, has very little left to make up the losses of the previous years. The position of the Company in active competition with other co-operatives claiming, and for a long period accorded, tax exemption is, therefore, more serious.

This Company has country elevators in the three Provinces of Manitoba, Saskatchewan and Alberta, and the following table shows the number of points where it is in competition with one of the three Pool elevator companies:

c	No. of Points at Which U.G.G. Operates Elevators	No. of Points Where there is Competition Between Pool and U.G.G.		
Manitoba	110_	. 52		
Saskatchewan .	108	100		
Alberta		193		

Some years ago the Company came to the conclusion that the unequal tax situation existing between its principal competitors and itself would ultimately have a disastrous effect upon its business and that it must seek equality of treatment. Some informal representations made to the Commissioner of Income Tax were followed in June, 1941, by a formal submission. The Government had announced on May 15th, 1941, that the tax status of the Pool Elevator Companies was the subject of study. This Company, in its submission, asked that its status be included in that study to determine whether in any material respect it was distinguishable from those competing companies. The submission asserted that if existing legislation was to be interpreted so as to give competing organizations exemption from taxation, this Company was in duty bound to seek equality by claiming similar relief.

Again it will be noted from the table that following the reorganization of the Company under the amending Act of 1941 and the assurances given its members in the discussion of the reorganization plan at the Annual Meetings of 1939 and 1940 of its intention to pay patronage dividends, the Company, on February 15th, 1942, paid out the sum of \$200,000 on that account for the fiscal year ending July 31st, 1941, calculated on the basis of one-half cent per bushel. In making this payment the Company had reason to believe that the amount would be tax exempt, and had assurance to that effect in a letter from the Inspector of Income Tax at Winnipeg, dated November 7th, 1944, which contains the following:

"A corporation which makes distributions of its earnings to shareholders on the basis of capital invested cannot fall within the provisions of Section 4 (p), and, hence, is subject to tax as an ordinary corporation. However, to the extent that such corporation makes returns to its customers or members on the basis of business done with the corporation, then to this extent it has made no profit, as it is dealing with the commodities in question at cost only; and any so-called earnings are really not income at all."

Later, however, some concern was apparently felt in the office of the Commissioner of Income Tax over the payment of patronage dividends by this and other grain handling organizations, for the Company

received a letter from the Commissioner dated February 19th. 1943. to the effect that upon the basis of an opinion received from the Department of Justice, any payments of this kind would not be allowed as a deductible expense. We understand that similar letters were received by other grain handling companies. We do not know whether a similar letter was directed to any of the three Wheat Pools. We do know that this Company could not accept that ruling in justice to its position as a co-operative authorized by Parliament to distribute its earnings in that way or to its position as a competitor of three co-operative organizations which continued to make such payments. Accordingly for the years 1942, 1943 and 1944 the sums of \$375,000, \$400,000 and \$1,225,000 were set aside for patronage dividends, and the Company's members and customers were notified that these sums had been so set aside and allocated pending the decision of the Courts. They were also notified that if the Company should be found liable to taxation in connection therewith. the greater part of the amount in question would be absorbed in taxes The fact that patronage dividends were not being paid by this Company, while its competitors, either free from, or disregarding Income Tax liability, continued to make such payments, has occasioned loss of goodwill. Were a similar condition to continue for any length of time, after the present congestion of elevator space is lessened, the Company could not hope to maintain its business.

Finally, the attention of the Commission is called to the position of the Company, as shown by the table for the years 1940 to 1944, inclusive. It will be observed that the Company will pay an amount of \$920,911.00 in Income and Excess Profits Taxes for those five years. If it happens that the amounts paid or allocated for patronage dividends are not allowed as deductible then the total amount will be increased to \$3,464,407.00. That is the measure in dollars of the burden of income taxation upon this Company in five years. If the amount of taxation in the last four years is related to the bushelage handled then it appears that the Company will pay almost one-half cent per bushel with the possibility of paying nearly one and a half cents per bushel over those years if patronage dividends are not allowed. In the year 1944 taxation on this latter basis would amount to nearly two and a half cents per bushel. By contrast the rate per bushel in 1929 was just over onetenth of a cent per bushel. To that extent has taxation increased. In addition it has required during those years an average of one-half cent per bushel to enable the Company to pay a five per cent dividend on share capital. A patronage dividend of one-half cent per bushel is a very desirable one at any time. It is obvious then the handicap which this Company suffers as against competitors which pay no interest on capital and may be relieved from any Income Tax liability.

SOME GENERAL CONSIDERATIONS

In the foregoing pages we have described the business, the organization and the tax position of this Company, and have shown that it cannot survive under continued tax discrimination. In this section we desire to offer some general comments on the existing legislation.

If, as seems to have been the opinion of Parliament in 1930, it was desirable that co-operative organizations should be exempt from Income Tax, then it would appear that Section 4 (p) has not only failed to accomplish that end, but has led to unjustifiable discrimination in the treatment of companies and associations equally co-operative in their form of organization and in their objectives and even between co-operatives carrying on the same kind of business in the same way. That other co-operatives hold the same views, was shown by the submission made by a delegation representing co-operatives across Canada, which waited upon members of the Dominion Government on July 12th, 1944, and probably the acceptance of that opinion was one of the reasons for issuing your Commission.

In three respects particularly the section, as it has been interpreted, results in discrimination as between corporations all essentially co-operative in nature:

- 1. With respect to the payment of dividends by co-operatives organized on a share capital basis.
- 2. With respect to the percentage of business which is permitted to he done with non-members, and
- 3. With respect to the nature of the obligation referred to in the section.

Dealing with the first point, the letter of November 7th, 1941, quoted on p. 19 hereof, makes it clear that the Income Tax Department has ruled that if a co-operative pays dividends on share capital, it cannot come under the provisions of Section 4 (p). You have heard evidence that other co-operatives have understood that to be the Department's ruling.

Assuming the ruling of the Department to be correct, this section is inequitable as between different methods of raising capital requirements and has encouraged the adoption of a variety of

plans to provide such capital either in such form as to make interest a properly deductible expense or without any liability for interest whatsoever. We refer to the raising of capital in the shape of loan capital and the withholding of cash represented by deferred payment certificates without interest. We do not believe that the prevailing practice among many co-operatives in Western Canada, of not paying interest on loan capital, or of retaining cash represented by deferred certificates arises solely from any widespread objection to the payment or receipt of interest as such. It appears to be based on the desire to come within Section 4 (p). We believe the practice encourages a hasty expansion of business and the development of business without suitable reserves, which in less prosperous times might again result in the disappearance of a great many co-operatives such as has occurred before. We believe that the recognition of the right of a co-operative to have interest or dividends on capital regarded as deductible would discourage the extreme use of the other methods of financing above mentioned.

Our contention is that there should be no difference for taxation purposes between co-operatives organized on a share capital or on a loan basis. We submit that a co-operative is entitled to have reasonable dividends on share capital regarded as an expense in the same way as one organized on a loan capital basis is entitled to have interest on its loan capital so regarded.

Moreover, we believe that to the extent that the fear of tax liability does encourage the use of non-interest bearing capital, to that extent it increases the discrimination against a co-operative that is legally or morally bound to pay dividends on capital, especially having regard to the present high levels of Income Tax. To pay a 5 per cent dividend on this Company's capital of \$3,200,000.00 requires approximately \$160,000.00. To pay this dividend and take care of Income Tax an amount of over \$275,000.00 is required. Another co-operative with the same capital might pay no interest and, therefore, no Income Tax. The advantage which that difference presents in confronting questions of handling and storage charges or in paying patronage dividends is obvious.

Again it is pointed out that the refusal to allow dividends paid on share capital as an expense makes it impossible for certain co-operatives to take advantage of the exempting section though they are incorporated as co-operatives under legislation passed by provincial legislatures. It has been seen that both the Co-operative Associations Act of Alberta and the Charter of this Company require the payment of dividends on capital stock as a pre-requisite to the payment of patronage dividends, so that it is clearly impossible for

certain co-operative corporations both to comply with the law of their being and obtain exemption under Section 4 (p).

It has been difficult for this Company to understand why a Canadian taxation law should be so framed and interpreted that co-operative organizations following closely the Rochdale plan of share capital organization should be subject to taxation if they pay interest on that capital while those following a later pattern of organization, introduced into Canada from the United States, should be permitted a preferred position, even if that pattern is in form well adapted to escaping Income Tax.

We further suggest that any exempting clause which has led to such a wide variety of plans to escape assessment, as now prevails in Canada, is bad legislation. Capital funds are essential to any business, or industry. It surely is not the intent of the Parliament of Canada to discourage a reasonable reward being paid for such capital. It is suggested that any exempting section should clearly show that a reasonable rate of dividend, say, five per cent, should be permitted as part of the operating expense of any co-operative whether it takes the form of loan capital or share capital.

As to the second point, the proviso to Section 4 (p), which limits the percentage of business with non-members to twenty per cent of the value of business with members is too strict a limitation. Under the American Act business with non-members to the extent of fifty per cent is permitted.

It is unfair, unjust and inequitable as between organizations equally co-operative in form and method of doing business. One co-operative in a particular line of business may find it comparatively easy to keep its non-member business within the prescribed limits and thus enjoys complete exemption; another by reason of the nature of its business, the necessity of doing business with everyone who wishes to do business with it, or the necessity of doing a considerable amount of casual business, may exceed the twenty per cent limit of non-member business and suffer the penalty of being completely taxable. That limitation, resulting as it does in discrimination between organizations equally co-operative, is too severe.

It leads to extreme measures to keep the appearance of member business within the prescribed limits. Your Commission has met examples of such methods, such as an extremely low membership fee, in many cases \$1.00, and in some cases even less, and the deduction of such nominal membership fees from patronage dividends, so that in effect the member makes no real contribution, but finds the membership fee paid by a very slight deduction from earnings on his

business. We do not suggest that there is anything improper in these methods, but do suggest that legislation is unfair and inequitable which makes it possible for organizations adopting such plans to be completely exempt, while other organizations of exactly the same type whose members have made some real contribution to the organization of the co-operative are taxable.

This proviso has been particularly difficult to comply with during the past five years in the elevator business. The operators of public country elevators are required, both under the Canada Grain Act and by their contracts with The Canadian Wheat Board, to take grain from any producer as offered, whether or not he is a member of the co-operative. Under conditions of elevator congestion and regulation of deliveries under quotas set by The Canadian Wheat Board, farmers have gone to other than their accustomed elevators. In addition, there have been the usual changes in customers, as the result of choice, of changes in occupancy of farms and of the death or retirement of members. For reasons quite beyond its control, it has been difficult if not impossible, without considering new memberships to have been retroactive, for any co-operative elevator company to keep its non-member business within the limits of this section. Prevented during a period of years, by the tax situation, from paying out patronage dividends and thus bringing in new members, this Company has not been able to meet such requirements.

One suggestion which has been put forward to meet such difficulties is to recognize as tax-exempt, earnings derived from business with members, and as subject to taxation earnings derived from business with non-members. However such a formula might work elsewhere, it is quite impracticable in the elevator business to make such a distinction as to sources of revenue. Moreover, it would involve problems difficult of solution with respect to revenues derived from The Canadian Wheat Board as well as from exporters who may elect to keep in storage grain bought and stored in the elevators of a co-operative elevator company.

A sounder plan would be frankly to recognize the situation, and to permit a larger percentage of business to originate with non-members.

Referring now to the third point, the meaning of the word "obligation" as used in the Section is not clear. It is difficult to know whether the reference is to a contractual obligation, express or implied, a statutory or a moral obligation.

The use of the word "obligation" is another reason for believing that Section 4 (p) was drawn with the contract pool form of organi-

zation in mind. Under that form of organization, now discontinued in the grain business, there was an obligation enforceable by law under the terms of the contract. Members of organizations now operating elevators cannot demand an accounting through appropriate Court action. In a practical sense the use of the word implies the right of members to enforce an accounting. Your observations of co-operatives already before you will have shown very few in which the member is given, or has that right. In the majority of cases there is no more than a declaration of intent, the fulfilment of which, in whole or in part, rests with the Directors or the Annual Meeting of members. Reference to obligation might reasonably be climinated from any exempting section of the Act.

VIII

CONCLUSIONS -

The first principle of a sound taxation system is equality of treatment. In the preceding pages we have shown that Section 4 (p) does not apply impartially to co-operatives, and that it has led to extreme and unusual forms of co-operative organization in efforts to insure exemption.

In particular we have shown that this Company is farmerowned and controlled with a membership of some 35,000 prairie farmers; that in its origin it was a direct out-growth of the farmer movement in Western Canada and still occupies a prominent place in that movement; that it is democratically controlled with those limitations of voting rights and capital holding common to co-operatives; that it handles farmers' grain from the driveway of the country elevator to the cargo vessel at Lakehead or Vancouver in exactly the same way as any competitor; that surplus earnings have not been used to pay large dividends on capital but for greater and more. extended services to its members; that only in its method of providing capital does it differ from co-operatives more recently formed, and in that respect it follows the British form of organization rather than the American; and that it is empowered to pay patronage dividends by the Parliament of Canada which passed the Income War Tax Act.

For these reasons the Company has insisted and still insists that any legislation which exempts competing co-operatives while still subjecting it to taxation, is inequitable and discriminatory and is not soundly conceived for the purposes for which it was intended.

The Company has been in existence for nearly forty years. It started in 1906 in a small and humble way. It has prospered and grown to a very considerable size. Throughout its history it has met privately-owned competition on even terms, It has never sought and does not now seek any preferential treatment for itself. It has faith in the co-operative way of business. It believes that co-operation is a vital and living force which under proper guidance can continue to exist and flourish without any special advantage over competitors.

In endeavouring to find a fair and equitable basis for the application of the Income War Tax Act with respect to co-operatives and companies in competition with co-operatives, your Commission will probably meet more difficulty in appraising the position of those

engaged in the elevator business than of those in any other business. It is the only field in which all operators are subject to full and complete governmental regulations as public utilities, High capital investment is necessary and the income of operators from year to year is highly variable.

The impact of taxation under the Income War Tax Act and the Excess Profits Tax Act is greater in a business where the income fluctuates greatly as between one year and another, or between one period and another, in contrast with a business where income is more regular from year to year. A company subject to taxation on the present scale has practically no opportunity, during years of high and unexpected earnings such as have recently been experienced, to recover losses made in earlier years, to accumulate reserves against future periods of low earnings, or to provide for expansion or improvements in facilities. A tax-paying company is consequently placed in a position of extreme disadvantage as compared with a competitor which is not paying taxes.

A reference to the table on page 24 shows also that the position has been very much aggravated by the Excess Profits Tax Act. For the years 1941 to 1944, inclusive, if the amounts set aside by the Company for patronage dividends are not allowed as exempt, taxes payable by the Company will be increased for the four years by an estimated \$1,543,000.00. Taxes would then amount to one and a half cents per bushel on the gross handling of the Company in those years. To the extent that the earnings of the Company for those years was due to war conditions, every company, co-operative or otherwise, has been benefitted by those conditions: to the extent that the earnings were the result of unusual crop conditions only, all the companies benefitted in the same way. We repeat there has been no substantial difference in operating methods. It is to be expected, of course, that the Excess Profits Tax Act is a wartime Act only and that taxpayers may look forward with some hope of an early repeal or at least some modification thereof. The repeal of that Act would go far towards ameliorating competitive conditions in the future. But unless the discriminatory application of the Act in the past few years is also removed, the effect will be disastrous against those bearing the burden of the tax.

The Company considers tax discrimination in this field to hold dangerous possibilities, not for the non-co-operative companies, which can speak for themselves, but for the whole farming community. Such dangers are not confined to producing inferior service or lower returns to one group of farmers as compared to another group. They include the possibility of competitive conditions which might impair the stability or solvency of organizations giving

necessary service to western farmers, both co-operative and non-co-operative, the disappearance or bankruptcy of any of which as the result of the tax situation or conditions resulting therefrom, would have widespread and serious consequences. Continued tax discrimination will further impair the ability of the Board of Grain Commissioners to exercise impartially its duties of regulation, and the ability of The Canadian Wheat Board to make uniform arrangements with its agents.

The Board of Directors of this Company considers the British method of dealing with taxation of corporations, both co-operative and otherwise, as superior to the method which has been followed in Canada. Adoption of the British system would largely solve the problem before you. If a recommendation to that effect goes beyond the powers of your Commission, we trust you will find in order a recommendation to the effect that the possibilities of following the British precedent should be carefully studied in Canada.

In Great Britain a problem similar to that which you are considering was solved by treating as deductible expenses for Income Tax purposes, all patronage dividends and payments analagous thereto whether paid by a co-operative or an ordinary corporation, and in all other respects subjecting co-operatives to the same taxation as imposed upon other companies. That measure was possible there because both co-operatives and other corporations were already relieved of taxes in respect of dividends paid on capital stock, while in addition all co-operatives in Great Britain had been organized on the capital stock basis. A satisfactory solution in Canada will not be practicable by adopting the British system with respect to patronage dividends and payments analagous thereto unless at the same time there is dealt with the problem of dividends on capital stock paid by a co-operative. The exemption of patronage dividends only would continue to be discriminatory against all those co-operatives organized on the Rochdale plan with share capital, and such discrimination would be particularly onerous with respect to this Company. With only patronage dividends exempt and taxation imposed on dividends on share capital then this Company estimates that the amount required to pay such dividends and Income Tax as would be then assessable, would amount in some years to roughly one cent per bushel on the Company's handling. Other co-operative elevator companies competing with this Company and not paving interest on their capital would be able to pay higher patronage dividends than could be paid by this Company, and their continuing ability to do so even to the extent of one-half cent per bushel would have a disastrous effect on the Company's business just as soon as the present pressure on elevator space is lessened. If for example certain corporations may have without taxation all the advantages

of their proportionately high earnings for those years, the benefit is permanent and far-reaching either in the goodwill created by the payment of dividends or the strong cash position that may be established by withholding cash and issuing deferred payment certificates. The latter procedure also enables such companies to recover more quickly from losses sustained in previous years when operating results were unfavourable.

The Company is convinced that you will not find a solution of the problem simply by eliminating Section 4 (p) and attempting to tax the income of all co-operatives for the following reasons:

- (a) Such a change would be widely resented and it is questionable whether it would have the necessary degree of public support to make such a proposal practicable in Parliament.
 - (b) Co-operatives doing business on a contractual basis are probably exempt, as having little or no income, apart entirely from any exempting clause in the Income War Tax Act. Unless the Government went so far as to specifically provide for the taxation of co-operatives organized on that basis there would probably be a revival of the contractual agency basis of operation in one form or another.
- (c) It is probably a matter of doubt as to whether bona fide patronage dividends are subject to taxation quite apart from any exempting clause, and it is highly desirable that for the future the law should be clear and certain in this respect.
- (d) Co-operatives whose capital has been provided on a loan basis are presumably tax exempt with respect to interest paid thereon.

For the foregoing reasons this Company believes that a solution will be found in a modification of the British method along lines somewhat as follows:

A: As to Co-operatives:

- (1) By recognizing as a deductible expense for the calculation of Income Tax, patronage dividends paid by any co-operative authorized to make such payments by the legislation under which it is incorporated.
- (2) By recognizing as a deductible expense for the calculation of Income Tax, dividends up to 5% paid by a co-operative organized on a capital stock basis.

(3) If a limitation with respect to non-member business is considered necessary, by permitting such business to a higher percentage than is provided at present in Section 4 (p).

B: As to Other Corporations in Direct and Close Competition with Co-operatives:

Pending such time as the Government can see its way clear to adopt the British system to grant relief to such companies as follows:

- (1) By recognizing payments analogous to patronage dividends as expenditures necessary to obtain and preserve business.
- (2) To allow as a deductible expense for the calculation of Income Tax, dividends actually paid on capital employed, not to exceed 5%.
- (3) Such other relief as may be necessary to companies in competition with co-operatives.

Relief under this heading "B" might be granted by the Commissioner of Income Tax who would be empowered to grant it or by a provision for review by a quasi judicial body, such as a Board of Referees.

The extent of possible loss to the Dominion Treasury by the special treatment above suggested for co-operatives and corporations in direct competition therewith, is probably not great. It is important to bear in mind the extent to which the income of co-operatives may be deliberately reduced if patronage dividends are not allowed as deductible, as well as the extent to which the income of companies in competition with co-operatives might be reduced, if inequality of taxation is continued, through the necessity of meeting that competition and preserving business.

APPENDIX "A"

"Legal Phases of Co-operative Associations," by L. S. Hulbert, is published by the Co-operative Besparch and Service Division, Farm Creat Administration, United States Department of Agriculture, as Bulletin No. 50, May, 1942.

It provides, commencing on page 385, suggested organization forms. The suggested articles of incorporation for a co-operative with capital stock are at p. 390 et seq., of which Article VII, p. 392, provides for both common stock on the principle of "one man, one vote," and for non-voting preferred redeemable shares. Corresponding references in suggested by-laws are on pp. 399, 400, 404 and 405.

A pamphlet issued by the Federal Farm Board of the United States as Bulletin No. 5 is still circulated, although it is dated January, 1931, under the title, "Grain—Guide for Organizing Local Co-operative Marketing Associations." That pamphlet recommends the raising of capital by the issue of non-voting preferred shares (pp. 8, 22 and 26). The same pamphlet shows that a rate of dividend on capital stock of co-operatives is contemplated

both by the Capper Volstead Act (p. 43) and the Federal Income Tax Act (p. 3). The following priorities in distribution of income are recommended after the payment of expenses, provision for depreciation, and provision for payment of interest and principal of long time obligations and amortized debts of the association:

- 1. Provision for reserve, until the reserve is equal to the paid-up capital.
- 2. Payment not to exceed 8 per cent on the capital stock.
- 3. Setting aside a percentage of the net earnings as a fund for the retirement of any indebtedness of the association.
- 4. Setting aside not more than 5 per cent of net earnings as an educational and community reserve.
- 5. Patronage refund subject to the discretion of the Board of Directors to delay payment, until sufficient sums have been accumulated, without borrowing, to permit payment in cash.

APPENDIX "B"

Extracts from: CO-OPERATION AT HOME AND ABROAD

By Professor C. R. Fay (Third Edition, 1925, p. 439 et seq.)

1. The Co-operative Foundations, 1900-22.

(1) THE PRAIRIE PROVINCES AND IN PARTICULAR MANITOBA AND ALBERTA.

"The picture in this section has reference to the end of 1922, but as the co-operative foundations persist and function in the new era, the figures have been brought down to 1924, where possible.

"Historically the co-operative movement on the prairies is a confluence of two streamsthe informal co-operation of farmer pioneers, and the dissatisfaction of the wheat grower with the treatment received from the railway companies and the line elevators. The pioneers. helped each other at barn-raisings and threshing bees. Being often far away from a railway they organized Beef Rings, taking turns to supply a whole animal which when divided up among the members' secured to each a regular. supply of fresh meat throughout the season; and such rings exist today. But if the provision of fresh meat was a convenience, the satisfactory disposal of the wheat crop was a pressing necessity; and after the Manitoba Grain Act of 1900 had given to the farmer the right to a car, in his turn, and freedom of shipment over the platform, neighboring farmers banded together to fill the car allotted to one of them. In 1901-2 grain growers' associations sprang up to enforce and improve the Grain Act. From protest they proceeded to investigation and from investigation to action, forming in 1906 at Winnipeg The Grain Growers' Grain Company.

"In its first season (1906-7), ten months) the Grain Growers' Grain Company, handled over 2,000,000 bushels of grain, the whole on commission; in the year ending August 31, 1916, during which the bumper crop of 1915 was marketed, the Company handled 48,000,000 bushels, 30 million through its commission department and 18 million through its country

elevators. At first no member might hold more than four shares, but in 1911, in view of the extension of trading activities, wider charter powers were obtained from the Dominion Government, and the maximum was increased to 40, but the rule of one man, one vote, still obtains. By 1916 the Company had 18,731 shareholders scattered over Western Canada (Manitoba, 8,655, Saškatchewan, 7,246, Alberta, 1,356, elsewhere 1,474). In June, 1917, the Grain Growers' Grain Company amalgamated with the Alberta Farmers' Co-operative Elevator Company, which had been established under provincial charter in 1913, on the plan of the Saskatchewan Company hereinafter described.

"The new style of the Company was The United Grain Growers Limited. Mr. T. A. Crerar, who had been President of the Grain Growers' Grain Company since 1907, becoming President of the united company, and Mr. C. Rice-Jones, who had been a Director of the Alberta Company, becoming First Vice-President. The amalgamation was beneficial for two reasons: (1) It eliminated overlapping in Alberta, and facilitated the integration of functions between the rapidly growing mixedfarming province of Alberta and the metropolitan market of Winnipeg; (2) it was the occasion of introducing into the parent organization a more thorough local system, the shareholders in each locality being henceforth represented through delegates at the Annual Meeting on lines similar to those employed in the federation of stores which compose the English Co-operative Wholesale Society. The Saskatchewan Co-operative Elevator. Company, however, has retained a separate existence.

"The Grant Growers' Company began with sale on Commission. In 1908 it entered

the export business. In 1912 it undertook the operation of terminal and country elevators, leasing a terminal elevator at Fort William from the Canadian Pacific Railway and taking over the country elevators which the Manitoba Government had erected in 1910, in response to strong pressure, but had operated at a loss. The Company subsequently built terminal elevators of its own, so that it now owns and operates both terminal and country elevators, in addition to operating the country elevators leased from the Manitoba Government, In 1912 the Company began to handle supplies, acquiring a timber limit in British Columbia with a view to the provision of building materials, leasing a flour mill in Manitoba and acting as agent for the purchase of fruit and coal in carload lots. Then followed wire, binder twine, machinery and other farm supplies. The marketing of live stock on commission presented a new field for co-operation, to handle which a livestock department was opened in 1916 with an office at the Union Stockyards in Winnipeg; while to secure co-ordination at the point of original shipment, live stock shippers' associations were organized. Alberta, the leading cattle province, entered the field of co-operative cattle marketing as early as 1914, and before long the United Grain Growers headed the list of shippers in the leading cattle markets of the West, Of the carloads handled by all firms in the year 1920-21, the United Grain Growers had at Winnipeg 18.7 per cent., at Moose Jaw 41.4 per cent., at Calgary 31.1 per cent., at Prince Albert 47.6 per cent. At Moose Jaw and Prince Albert they have offices in the co-operative stockyards organized by the Province of Saskatchewan.

"As constituted in 1923, the United Grain Growers Limited comprised (1) The main company with its several departments—grain (elevator and commission), terminal elevators, live stock, farm machinery and supplies, accounting, organization (including propaganda, advertising, mailing lists and shareholders' files); (2) the following subsidiary companies—Grain Growers Export Company Limited (Canadian Company), Grain Growers Export Company Inc. (New-York Company), Grain Growers' Guide and Public Press Ltd., United Grain Growers Securities Ltd. (insurance department and land commission agency), U.G.G. Sawmills Ltd.

"The general balance sheet for the year A ending August, 1921, showed a net profit, subject to taxes, of \$233,000, as compared with \$467,000 for 1920, and \$148,000 for 1919, and this sum, after provision for reserves and educational grants allowed of a 6 per cent. dividend. (Figures for the year ending August, 1924: net profit, \$552,000; dividend, 8 per cent.) The main profits have been made on the grain and live stock business, the other departments. being less successful, and some of them showing substantial losses. In 1924 the United Grain Growers handled no farm machinery beyond repairs necessary to meet the requirements of machinery sold while it was in that business. Thus the general experience of European countries that co-operative supply is easier to handle than co-operative sale is reversed; and for this there are historical reasons. The better marketing of grain was the raison d'etre of co-operative effort in the West. The farmers felt themselves to be exploited by existing organizations, and gave their Company a large volume of custom. It only remained for the Company to become as efficient technically, or approximately so, as existing private con-

"The established grain marketing structure being elaborate and highly specialized, the Company had to accommodate itself to this fact. It had to offer to the farmer outright purchase, sale on commission, purchase or storage subject to grade, special binning and so forth; and as the operator of country and terminal elevators, it became subject to the same obligations to the general public as private concerns. Prior to the organization of the wheat pools, to which it gave some assistance in organization and with which it now seeks to co-operate, the Company confined itself to what was practicable at the time. At local points it gave improved services and brought down charges: at the central market it watched the farmers' interests, investigating complaints, and helping to dispel the irritation of the producer with a marketing machinery, which from its intricacy seemed to him mysterious and malevolent. Where it could, it rendered new service. For example, its representative in the government grading room on the top floor of the Winnipeg Grain Exchange unofficially inspects the samples of wheat belonging to the Company or to individual members, and after the grade has been assigned,

asks for a re-examination when there is a prospect of its being raised.

"But when it developed the export business it could not adopt the simple plan of handling only its own wheat any more than the Scottish Co-operative Wholesale Society can convey. to its members the actual wheat grown on its farm at Hughton in Saskatchewan. Therefore the Grain Growers Export Company of Cappen

buys from outside parties, as well as from the parent Company; but it does not get the latter's wheat unless it bids up to the top price, and it could not conform to the lightning rapidity and fractional profit at which business is done unless in its turn it were free to take grain from any source that offered."